TESTIMONY OF

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BEFORE THE SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

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Good morning, Mr. Chairman and members of the Committee. My name is Leo Hindery. I am the President of Tele-Communications, Inc. ("TCI").

Thank you for inviting me here to testify today. I know that the primary focus of this hearing is cable rates, and I will get to that issue in detail. But before I do, I'd like to take a few minutes to describe two recent developments at TCI and how these developments will provide impressive benefits for consumers. First, of course, is the merger between TCI and AT&T. We are very excited about this merger and the opportunity to offer consumers a broad range of video, telephone and data services. Second, is TCI's, and the cable industry's, recent creation of regional system clusters that provide the reach and concentration necessary to provide these services.

THE RESTRUCTURING OF TCI

The Merger of AT&T and TCI

On June 24, AT&T and TCI announced that the two companies would merge to create a dynamic new company that will provide the most powerful selection of high-quality, high-value communications products and services ever offered by a single entity. I would like to spend a few moments providing some context on the thinking that led TCI to join forces with AT&T and on the vision I have for the future of this merged company.

After the merger is completed, AT&T will combine its current consumer long distance, wireless and Internet service divisions with TCI's cable, telecommunications and high-speed Internet businesses to create a new subsidiary -- AT&T Consumer Services. I will serve as president of this company.

AT&T Consumer Services will offer consumers an extraordinary range of communications services, all under the AT&T brand name. The ability to offer consumers a fully integrated package of communications, information, educational, electronic commerce and video entertainment services was a driving vision behind this merger, and I believe it will redefine the telecommunications industry over the next several years. AT&T Consumer Services will be the first truly one-stop communications opportunity for all consumers, making it easier for them to subscribe to, upgrade, downgrade and customize the communications services of their choice. And they will do so with the convenience of a single bill.

AT&T Consumer Services will offer this integrated package of services over a highly sophisticated broadband network platform. This platform will have three primary parts: (1) a rebuilt broadband network infrastructure; (2) upgraded headends; and (3) advanced digital multi-purpose customer terminals.

The broadband infrastructure will consist of two-way capable systems upgraded to 550 MHz and 750 MHz. TCI's cable headends will be transformed into the nerve centers of a high-tech network based on "Internet-Protocol," or "IP," technology. IP technology will make it possible to offer consumers video, voice and data services in electronic "packets" over the same wire.

On the household side of the network, we will provide our customers with an advanced digital customer terminal. This terminal is not simply a device which descrambles signals and passes them through to TVs and VCRs. Rather, it is a highly complex network computer with enormous processing power and memory which will allow it to deliver a wide array of interactive video, data and telephony services to consumers. Unlike earlier generations of set-top devices, the digital terminal can be upgraded remotely from cable headends without ever having to enter the consumer's home. TCI and the cable industry have worked very hard through our OpenCable initiative to ensure that these digital terminals will: (1) combine the best technology from a cross-section of hardware and software providers at a reasonable price; and (2) be based on public standards that facilitate the sale of these terminals by a wide variety of retail outlets.

The level of technological sophistication required to implement two-way capability and integrate digital customer terminals into our network is substantial. A web of computer servers, routers, switches, nodes, fiber-optic and coaxial cable and gateways to other services, such as the Internet, must be linked in order to provide interactive digital services for consumers. These sophisticated networks are costly to build and require a high level of planning, design and coordination to deploy.

This is one of the key reasons why the merger with AT&T makes sense. AT&T brings to the table unparalleled technical expertise in the areas of network design and implementation. Moreover, AT&T provides a very strong financial base to our rebuild efforts. The merger will significantly accelerate the process of upgrading our networks and hasten the time in which we can deliver to consumers the types of advanced services Congress had in mind when it passed the Telecommunications Act of 1996.

Speaking of the 1996 Act, the merger is, in my opinion, the first truly significant effort to achieve Congress' goal of creating competition to the local telephone marketplace. AT&T Consumer Services is dedicated to providing aggressive and widespread competition to incumbent local telephone companies and, because of the advances in IP and other technologies that I mentioned above, we will be able to do so for about half the cost per line of a traditional circuit switched telephone system. As my new partner and boss, AT&T Chairman Mike Armstrong has said, we are sending a message to the Bell companies: "We intend to show up."

TCI's Clustering Strategy: A Return To Localism

Although our merger with AT&T was announced recently, we actually have been aggressively upgrading our networks in preparation for the provision of digital video, high speed data services and telephony for the past two years. Most importantly, we have restructured TCI's cable business to create regional "clusters" that allow us to focus more effectively on the needs and interests of our customers. Where one of our systems was next door to an operator which had a deeper presence in that market, TCI sought to create a joint venture and let the other operator manage the system. We have announced several of these ventures, and we are working on others. After we are finished, TCI will have reduced its size by about one-third, and it will no longer be the nation's largest cable operator.

I want to give you a little background on the factors that led us to pursue clustering. When I joined TCI 18 months ago, it was clear that the company confronted a number of serious issues, including faltering cash flow, subscriber losses, rapidly escalating costs (particularly for programming) and image problems at the local and national level. I did not think that TCI was broken, but I did think it could be helped. It seemed to me that TCI's problems were largely attributable to overcentralized management and a failure to focus on the fundamentally local nature of the cable business. In some sense, this was not surprising, since TCI and the cable industry have grown dramatically in the last 10 years. In the process, it was easy to lose sight of the fact that cable is a local business better run by local system managers who are empowered to take the initiatives necessary to better serve their customers.

These problems not only affected the day-to-day operation of our business, they directly impacted our ability to upgrade our infrastructure in a way that positioned us for the future. In order to address these issues, I accelerated TCI's strategy of combining its cable systems into geographic clusters. Clustering allows us to more keenly address the local needs of our customers and, at the same time, create larger, regional systems that can obtain the economies of scale and scope that are absolutely necessary to: 1) expand and improve the quality of our existing video product; 2) enhance the offering of interactive video and information services; and
3) facilitate the provision of competitive telephony services.

Clustering Will Allow Cable Operators To Expand And Improve The Quality Of Their Existing Video Product.

TCI and other cable operators experience several types of capital, operational and technological efficiencies from clustering. For example, clustering increases our ability to develop regional programming services, such as news and sports. Regional programming services are difficult for any single cable operator to develop if its systems cover only a fraction of a given metropolitan area. The ability to spread the costs of programming over a greater number of subscribers increases the prospects of success and, therefore, the likelihood that the operator will risk the cost of developing local and regional programming. Similarly, clustering permits cable operators to improve customer service. In a clustered environment, operators can centralize customer service and maintenance functions, reduce the number of call centers and better position truck fleets to offer quicker and superior service. Clustering also improves a cable operator's ability to sell local and regional advertising. Cable television generally has not attracted a share of local and regional advertising proportionate to the viewing of cable programming. This is because a single cable system typically does not reach a sufficiently large audience to make advertising expenditures attractive. Clustering increases the likelihood that local and regional merchants will purchase advertising spots on cable.

Let me give you a specific example of how we have dramatically improved our traditional video programming package. We recently implemented our new digital video package in our system in Washington, D.C. The D.C. system is a typical 450 MHz system. Prior to the digital upgrade, we offered 64 analog channels. The upgrade allowed us to designate three of those analog channels for digital services. Using sophisticated compression technology, we now offer our customers an additional 36 cable programming services, including eight channels of pay-per-view, plus 10 digital audio channels.

Some of the new services we added are Discovery Kids, Discovery Science, The History Channel, Fox Sports and ESPN 2, plus multiplexed premium services (e.g., HBO2, HBO3, etc.). I have attached to my testimony the digital channel lineup for the D.C. system so that you can see the entire slate of new services made possible by our digital upgrade.

We have already rolled out our digital package in many markets, and the service is now available to over 11 million of our customers. The reaction to our digital product has been phenomenal. Our customers have signed up for the service even faster than we expected. They have told us that they like digital's picture, sound, content and enhanced navigation. By the end of 1998, we expect to have nearly a million digital subscribers nationwide.

There really is no debate about the benefits of clustering. The FCC has noted that "regional concentration may result in significant efficiencies,"[41634] and "may also reflect the desire of cable operators to enter the telephone business, or [ ] strategic decisions by cable operators to position themselves to compete against [telcos] that are poised to enter the market for the

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41634 First Video Competition Report, 9 F.C.C.R. 7442, at ¶ 151 (1994).

distribution of multichannel video programming."[0] Similarly, NTIA has voiced the strong opinion of the Administration that clustering is essential to the future of telecommunications and that any potential harms of clustering are "largely conjectural, speculative, or de minimis."[5751]

Clustering Will Enhance Cable's Offering Of Interactive Video And Information Services.

Clustering will also facilitate cable operators' offering of new interactive services in a variety of ways. First, a larger, more focused subscriber base will reduce the per-subscriber cost of the expensive file servers, switches and high capacity storage devices that are necessary to provide interactive services. Clustering is therefore important to the viability of the services because smaller systems must bear the cost either of unused file server capacity, or of a smaller, less efficient file server. Moreover, the same efficiencies cannot be achieved by aggregating the demand from widely-separated systems because of the high cost of transmitting a large number of channels from a remote file server to a local system -- either by satellite or leased long-distance lines. Second, many of the other benefits of clustering described above for traditional video service also will make new services more attractive, including lower maintenance and operating costs, reduced repair times and improved service quality.

Let me describe for you one of the interactive cable services about which we are particularly excited and which, I believe, will benefit greatly from clustering. TCI recently began to deliver a content enriched, Internet service called "@Home." @Home is an amazing service. It connects personal computer users to the Internet using a cable modem that is literally hundreds of times faster than a typical telephone Internet connection. Relatively speaking, a two megabyte file takes more than nine minutes to download over the average 28.8K speed modem. The @Home service takes less than 10 seconds to download the same file.

@Home also provides user-friendly guide pages that allow consumers to find hundreds of

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0 Id. at ¶ 153 (citation omitted).

5751 Letter from Larry Irving, Assistant Secretary of Commerce, to the Honorable Janet D. Steiger, Chairman, Federal Trade Commission, January 12, 1995, at 2.

the most popular and entertaining web sites, as well as localized content, such as community calendars, business listings, arts and entertainment reviews and movie schedules, which allow consumers to connect to their neighborhood at the click of a mouse. And what some of our customers like most about @Home is that it is always on. No more dialing up over a phone line to get connected. No more chronic busy signals at peak times. Our @Home customers are able to get onto the Net as soon as they sit down at their PCs. @Home is currently available to TCI customers in Bay Area, CA; Hartford, CT; Chicago, IL; Dallas, TX; and Seattle, WA, with many additional market launches planned for the third and fourth quarters this year.

The ability to offer @Home in a regional cluster will make the service even more attractive to our customers. The cluster substantially increases the incentives to invest in the creation of local and regional programming. Similarly, clustering makes @Home a much more efficient advertising vehicle for local and regional merchants. And clustering increases the technical and economic efficiency of the @Home network, thereby allowing us to lower the costs of providing the service to our customers.

Clustering Is Critical To The Cable Industry's Efforts To Provide Local Telephony In Competition With Incumbent Local Telcos.

As I said earlier, the merged AT&T and TCI will compete aggressively in the local telephone market. Clustering is critical to our business plan because it substantially reduces the cost of providing local telephony. The profitability of offering telephony depends significantly on the proportion of cable subscribers who choose to take telephone service from their cable company. The ability to serve customers in dispersed cable systems from common routers, switches and network computers is limited. Because voice conversations and telephone signaling can tolerate only small time delays, this equipment must be located within a relatively short distance of a subscriber. Clustering allows cable operators to capture these types of economic efficiencies and that, in turn, makes telephony a much more attractive proposition.

The economics of clustering are particularly important because a cable operator seeking to provide telephony service will face a very well-established competitor with a very large market share, a ubiquitous footprint and a well-established reputation. I won't kid you. Competing in local telephony will not be an easy task. We have a lot of work to do, and there are still some regulatory issues to work out. In particular, I want to mention the FCC's proceeding to revise the current horizontal cap on cable operators. It is simply essential to the creation of a competitive local telephone market that the revised rule provide the flexibility necessary to allow cable operators to create clusters and obtain the national reach that it will take to compete with the incumbent local telephone companies.

A central policy underlying the 1996 Act was Congress' desire to increase competition in the local telephone market. I want to assure you that the merger of AT&T and TCI is premised on the delivery of local telephony, as well as advanced video and high speed data services, and we are absolutely committed to delivering on the promise of the 1996 Act.

Now let me turn to the issue of cable rates.

TCI'S PRICE STRUCTURE AND THE COMPLICATED SET OF FACTORS THAT IMPACT PRICES.

At the outset, I want to stress that we cannot discuss the issue of cable prices in a vacuum without reference to the variety of complicated factors that impact prices. Let me take a few minutes to describe some of the factors that go into the price decisions we have recently made.

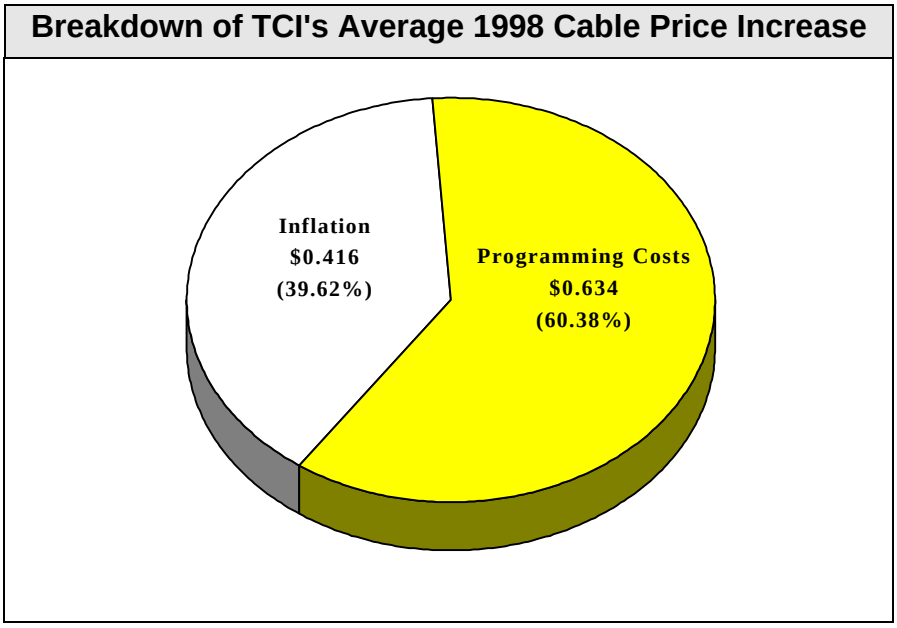
A. TCI's 1998 Cable Service Price Increase

In 1997, on a national basis, TCI's average regulated price for basic service was $11.34, and the average regulated price for expanded basic service or, using the FCC's term, cable programming services tier ("CPST"), was $15.79, for a combined total of $27.13. In 1998, the TCI average price for basic was $11.66 and the average price for CPST was $16.52, for a combined total of $28.18. Thus, on average, our regulated basic and CPST prices last year increased by about 3.9%.

In general, under the FCC's regulations, TCI can only increase its prices for the following reasons: inflation and external cost increases (i.e., increases primarily beyond the control of TCI).

- Inflation. Last year, inflation accounted for nearly 40% of TCI's average price increase.

External Costs. There are a variety of external costs specified under the FCC's rules (e.g., programming costs, state and local taxes, franchise-related costs and regulatory fees). However, of these, only increased programming costs had a material impact on TCI's 1998 price increase. Increased programming costs accounted for approximately 60% of TCI's average price increase.



As the above analysis demonstrates, programming costs play a particularly large role in determining price increases. TCI, like every other video programming provider, operates in a cost-increasing business in which consumers continually demand new programming. As our programming costs increase, it is natural that our prices will be affected.

Sports programming provides a good example of this phenomenon. Consider what happens when an athlete signs a $100 million contract to play for a professional team, an occurrence that is not uncommon these days. The team owner obviously needs to recoup that investment. So, he raises ticket and concession prices. In addition, he increases the price that the local or regional sports channel pays to televise the games. In turn, the local sports channel raises the rates it charges TCI to carry the games. As a result, the prices that my customers pay increase as well.

A recent Report from Kagan Media Appraisals, Inc. provides strong empirical evidence for this analysis. According to Kagan, since the early 1990's, national media payments for sports rights have risen 32%.[4] The recent record-setting $18 billion NFL TV contract is a dramatic example of this trend. Programming cost increases are not limited to sports programming. Kagan found that production costs of motion pictures have risen 33% in the last four years, and the prices charged to basic cable networks to license syndicated TV series nearly doubled over the same period.[5]

As Kagan points out, programming cost increases place "acute" pressure on all TV networks:

The cost of creating film, TV and sports entertainment have been rising at rates much faster than inflation. This upward cost trend is due in part to the changing economics of a worldwide entertainment industry, where success is measured in the hundreds of millions of dollars. In particular, the expectations of those in the limited talent pool who can consistently achieve success have grown dramatically. And the resulting cost increases to produce movies and television series and obtain rights to major league sports over the last decade have impacted all networks -- broadcast and cable.[6]

Kagan's conclusions are consistent with TCI's own experience. On the following page is a graph comparing the consumer price index with TCI's programming cost increases in 31 large cable systems in the states represented by the Committee members. As you can see, TCI's programming costs have far exceeded inflation during the five-year period. This chart also illustrates that even as its programming costs were dramatically increasing, TCI's per-channel rate remained relatively stable over this same period.

Some parties have attempted to downplay the impact of programming cost increases. They assert that operators who also own programming engage in a "shell game" whereby they artificially raise programming costs which are passed on to consumers, thus allowing the operators to take their increased profits in their programming business rather than their cable business. This criticism is entirely without merit.

If artificially-inflated costs for affiliated programming explained increasing cable prices, then the costs of affiliated programming would be increasing faster than the costs of non-affiliated programming. But, in fact, just the opposite is occurring. For example, from 1996 to 1997, TCI's costs for affiliated programming rose 18%, while its costs for non-affiliated programming rose 29%. Similarly, from 1997 to 1998, TCI's cost of affiliated programming rose 12%, compared

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4 "TV Programming Costs, An Analysis of the Market Forces Driving Entertainment and Sports Rights Fees," Kagan Media Appraisals, Inc., December 1997.

5 Id. at 1.

6 Id.

with an increase for non-affiliated programming of 16%. Stated another way, it is not credible to argue that affiliated programmers are artificially raising rates when their rate increases are below those imposed by non-affiliated programmers. Rather, affiliated programmers' rates are going up because, just like non-affiliated programmers, their underlying costs are going up.

Programming cost increases are the marketplace at work. I am not here to cast blame. But I do want to emphasize that this dynamic must be taken into account when one looks at cable price increases.

C. Quality Increases

One cannot discuss the issue of prices without also looking at the substantial increases TCI has made in the quality of the service it offers consumers. In other words, to use the economists' terms, we must look at "quality-adjusted prices" to accurately determine the real cost to consumers.

Quality increases can take many forms. For example, over the past several years, TCI has significantly increased the number of new programming services it offers to its customers. Some of the new services we added were: Fox News, ESPN 2, The Learning Channel, C-SPAN 2, The History Channel, Animal Planet, The Sci-Fi Channel, The Food Network, The Comedy Channel, The Travel Channel and The Family Channel.

This trend was apparent on an industry-wide basis, as well. According to industry analyst Paul Kagan, between 1995 and 1997, the number of basic cable networks carried in the majority of cable households increased from 27 to 32, or by more than 18 percent.

In fact, if one takes into account these added channels, it appears that cable prices have been quite stable and in many cases actually have declined over the last several years. It is appropriate to look at prices on a per-channel basis since, as the FCC has noted, such an analysis "serves as a proxy for a quality adjustment."[7]

On the following page is a chart comparing the price per channel of basic and CPST in 1992 and 1998 for the following TCI systems**:** Tucson, AZ;[8] Overland Park; KS; Battle Creek, MI; Springfield, MO; Billings, MT; Reno, NV; Salem, OR; Corpus Christi, TX and Spokane, WA. In most of these systems, the price per channel has been declining. Even where the price per channel has gone up, the increase has been small, certainly lower than inflation for the period analyzed.

Some parties have criticized the cable industry's efforts to add programming, asserting that the programming added is low quality and not popular among subscribers. This assertion is simply false. These critics make the mistake of assuming that we only added niche services devoted to

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[7] FCC Report on Cable Industry Prices, FCC 96-499, MM Docket No. 92-266 (released January 2, 1997), at ¶ 22.

[8] TCI recently sold this system.

specialty programming and that those services are of little interest to our consumers. In fact, we added some widely popular services such as Fox News and ESPN 2. Moreover, niche services are highly valued by cable customers. For example, in the second quarter of 1998, The Comedy Channel increased primetime viewership by 75%, The Family Channel 30%, fX 33% and The Food Network and The Travel Channel 50%.

TCI also has made substantial investments to improve the quality of its infrastructure. This investment resulted in more channels, greater picture clarity, fewer service outages and the ability to offer new services such as telephony and high-speed Internet access. Last year, TCI spent nearly $2 billion on upgrading its cable systems. These costs are a critical and substantial element of our business, yet TCI funded these upgrades entirely through our shareholders and the financial markets, not on the backs of our video customers through unsupported price increases for basic or CPST services.

In addition, TCI has spent millions to improve its customer service capability and has embraced the industry's "On-Time Customer Service Guarantee" program. This program commits operators to do two things. First, installation appointments must be made on-time or the installation is free. Second, service appointments must be kept on-time or the customer receives a $20 credit.

Our industry's efforts to improve programming quality certainly are paying off. The evidence is in -- consumers are responding positively to our quality improvements. Recently, in fact, basic cable's viewing share during primetime exceeded the combined share of the four major broadcast networks for the first time in history. And cable programming is increasingly recognized for its quality with Emmy, Golden Globe and Oscar awards.

D. The Role of Competition

Any analysis of our prices must take into account the pivotal role of competition. Non-cable technologies have grown substantially in recent years and now provide significant competition to cable. This trend is steady and irreversible. More than 11 million consumers (or over 14% of all MVPD subscribers) now subscribe to cable's competitors. In the last year, twice as many people signed up for cable's competitors as signed up for cable. I respectfully submit that if the government saw this same level of competition in the local telephone arena, it would declare victory.

Let me give you an example of how this video competition impacts cable pricing decisions. The FCC's rate regulations specify a maximum permitted rate increase. Cable operators are free to impose lower rate increases. During 1998, on average across all of its regulated cable systems, TCI took price increases 6% below the maximum rate permitted by the FCC's rules. That is the "real life" impact of competition.

Now let me get a bit more specific about the competition we are facing.

Direct Broadcast Satellite ("DBS")

More than any other non-cable MVPD, DBS has fundamentally changed the competitive dynamics of the video marketplace. Consider the following facts about DBS:

- In the last five years, DBS subscribership has grown at an average annual rate of over 100%. By contrast, over the same period, cable subscribership has grown at an average annual rate of approximately 3%.

In the last 12 months alone, DBS subscribership grew 43% -- nearly 31 times as great as cable's growth rate in the last year.

Last month, the three DBS operators signed up nearly 5,500 new subscribers per day.

The DBS industry recently celebrated its strongest ever first quarter with an increase of nearly 500,000 new subscribers.

The DBS industry now serves over 7.2 million subscribers, or almost 10% of all MVPD subscribers nationwide. Meanwhile, cable's share of total MVPD subscribers decreased 5% from September 1996 to today.

DBS companies are bigger in terms of subscribers than most of the cable companies they challenge. DirecTV (with 3.8 M subs) is now comparable in size to the fifth largest cable operator; EchoStar (with 1.38 M subs) is now comparable in size to the 8th largest operator.

In 37 states, more than 10% of all TV households subscribe to a direct-to-home satellite service (including both K-band and C-band).

DBS service is available to virtually all single family residences in the U.S. Consumers wishing to subscribe to DBS can call several different 800 numbers from anywhere in the nation to get service. Stated another way, virtually all consumers have a choice of distributors from which to purchase their video services, including multiple DBS providers.

- DBS is not simply for "high income" individuals, as some would have you believe. In fact, DBS increasingly aims its ads at the average cable customer, not high-income families. I have attached to my testimony several examples of these ads.

This growth of DBS is likely to continue. DBS equipment prices are coming down dramatically, and this will increase the ability of DBS to compete with cable. Only a few years ago, consumers had to pay $699 for a DBS dish. Today, it is possible to get a DBS dish for not more than $199 and often for less. As the FCC's recent report points out, discount retailers, such

as Walmart, are selling equipment for $49, and some mail order firms are offering the equipment for as little as $25. In fact, PRIMESTAR does not even require its customers to purchase the dish.

Some have argued that cable's ability to deliver local broadcast signals is an advantage over DBS. I want to make clear that TCI and the cable industry do not oppose DBS carriage of local broadcast signals. But, we need to consider that issue in context. Cable operators are required by the "must carry" rules to carry all broadcast signals, including those that achieve very low viewership. Cable operators must devote up to one-third of their capacity to broadcast signals. And now there is even talk of additional must carry obligations for digital broadcast signals. Cable operators are also saddled with other obligations as a result of their carriage of broadcast signals, including the syndicated exclusivity, sports blackout and network non-duplication rules. In our view, if DBS operators want to carry local broadcast signals in the interest of "competitive parity" with cable, they should have to shoulder the same obligations as cable. In the alternative, if DBS operators are given the right to carry broadcast signals without obligations, then those obligations should be lifted for cable operators, as well. In this regard, I would also note that certain equipment manufacturers have integrated off-air antennas that fit on the back of a DBS dish, so that DBS subscribers are able to receive local broadcast signals. I know of at least two DBS operators which strongly support the use of such integrated devices, with plans to market national and local broadcast signals together in a test market sometime next year.

SMATV and MMDS

There are approximately 28 million apartment units in the United States, housing more than one-fourth of the nation's total population. These high density buildings are often the sites of vigorous video competition between cable operators, SMATVs and MMDS operators. As the FCC's recent video competition report concludes, "Technical, regulatory, and programming supply developments appear to be contributing to the emergence of a distinct MDU market, which is more competitive than other MVPD markets." (¶ 129) The FCC also noted that SMATV subscribership increased by almost 11% over the past year and that the recent introduction of digital technology by MMDS operators will increase the "ability of MMDS operators to compete better with cable systems." (¶ 77) Finally, DirecTV will soon begin selling to MDUs in partnership with SBC and Bell Atlantic, which will surely increase still further the level of competition in the MDU marketplace.

Telephone Companies

Provision of video service by telcos is also growing steadily. For example, Ameritech has been authorized to operate cable systems in over 75 communities serving more than 2.5 million homes. BellSouth has received cable franchises in at least 18 areas in Alabama, Florida, Georgia, South Carolina and Tennessee, passing over 1.2 million homes, and is actively competing in many of these areas already. The Southern New England Telephone Company, which is in the process of being acquired by SBC, has begun cable service and has plans to serve the entire state of Connecticut. GTE offers video services to more than 500,000 homes in Florida and California. Bell Atlantic operates an open video system in New Jersey and has announced plans to offer cable in Philadelphia.

And I can tell you that these telcos are not merely shadow boxing. They are tough competitors. For example, in Lincoln Park, Michigan, Ameritech has completely overbuilt TCI's franchise area. It is offering over 70 channels of programming and has signed up over 6,400 customers. In Ventura County, California, GTE has already signed up over 15,000 customers. Similarly, since BellSouth began offering video service in Vestavia Hills, Alabama, in December 1996, TCI has lost over 15% of its subscriber base. These results are aided by the fact that the FCC permits telcos to jointly market video service at the same time a new resident applies for phone service.

Broadcasters

Competition from over-the-air broadcasters remains prevalent and robust. During the 1996-1997 television season, the four major broadcast networks (i.e., ABC, CBS, Fox and NBC) accounted for a combined 59% share of prime time viewing among all television households. UPN and WB, the two newest networks, achieved a combined 9% share of prime time viewing. During this same period, the number of commercial and noncommercial TV stations increased from 1550 to 1561, and broadcast total advertising revenues reached $31.3 billion, compared to $4.9 billion for the cable industry during the same period.

Competition from broadcasters is likely to increase over the next several years, particularly in light of the FCC's decision to give every broadcaster an additional 6 MHz of spectrum. Digital broadcast launches are scheduled to begin this November in the top 10 U.S. markets. Broadcasters may use their new digital spectrum for any purpose, including the provision of higher quality HDTV signals, or, through compression, delivery of multichannel programming packages. Either of these options will put further competitive pressure on cable.

E. A La Carte Pricing Proposals

Some parties have suggested that cable operators should be required to provide more services on an a la carte basis, thereby giving consumers more flexibility to reduce their cable bill by not subscribing to particular services in which they have no interest. Although TCI does not support a government regulation dictating how cable operators may offer their services, it is not necessarily opposed to exploring voluntary a la carte pricing options.

However, I want to point out that a la carte pricing raises some very complex technical, economic and marketing issues. For example, operators cannot offer services on a channel-by-channel basis without an addressable set-top converter that can "read" a tag indicating whether a subscriber is authorized to receive a particular channel. Fewer than half of TCI's cable homes today have an addressable converter. Placing addressable converters in those homes that do not already have them would be costly, and those costs, of course, would have to be reflected in consumer's cable bills.

Moreover, a la carte pricing potentially could undermine the economic base of many basic cable programming services. Basic cable programmers depend on revenues generated from advertising

as well as license fees paid by the cable operator. The ability of a programmer to be marketed in a package with other popular services increases the potential audience for that programmer, and that, in turn, drives its advertising revenue. For all but a few of the most popular programming services, a la carte pricing would invariably and substantially reduce the potential audience. Naturally, this would decrease the attractiveness to advertisers. This problem is particularly acute for new programming services and niche, special interest programming, such as C-SPAN and C-SPAN 2. It is critical for such services to be in a package with other popular services. Without packaging, many existing services would fail.

In addition, the customer service and sales challenges of marketing video services in this manner would be enormous given the huge number of separate purchase decisions that each customer would have to make, since today there exist more than 160 non-premium, basic-type cable programming channels.

Even if these problems could be overcome, it is not clear to me that consumers would actually be better off in an expanded a la carte environment. For example, consider a consumer who is only interested in five niche services that currently can only be purchased in a package of 20 services for $20. It may be that if the consumer were able to get the five niche services a la carte, the bill would exceed $20 because the cost of the niche channels allocated over a dramatically smaller audience would actually exceed $4 per subscriber, per service. Our experience with moving The Disney Channel to a regulated tier demonstrates this point. The addition of Disney to the widely subscribed regulated tier added less than a dollar to the price of the tier. As an a la carte service, with a much smaller subscribership, Disney cost about $10.

Notwithstanding the complexities of a la carte pricing, I would be pleased to discuss this issue with interested parties. If there are pricing options that would benefit my customers, I am always interested in exploring them.

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Given the complexity and multiple factors impacting cable prices, as well as the irreversible trend of increased video competition, it simply makes no sense for the government to resurrect the tired and discredited regulatory prescriptions of the past. Additional price regulations are not only unnecessary and unwarranted, they would do significant damage, as they did in 1993 -- shutting down our cash flow, scaring off investors and thwarting innovation in new programming, services and technologies.

Finally, I would like to make a few brief comments about the important role of vertical

integration in the video industry.

THE ROLE OF VERTICAL INTEGRATION IN THE CREATION OF DIVERSE AND HIGH-QUALITY PROGRAMMING SERVICES.

Vertical Integration is on the Decline.

As an initial matter, I want to note that vertical integration in the cable industry is decreasing. As the FCC has found in its annual competition reports, the percentage of vertical integration of national satellite programming services declined in the past four years from 53% to just 40% this past year. In addition, the FCC found that there are 77 new services which are intending to launch and that 72 of these services (or 94%) have no cable affiliation. Now is hardly an appropriate time to be strengthening or extending regulations based on perceived problems with vertical integration.

Benefits of Vertical Integration

Moreover, it is well-established that vertical relationships between cable operators and programmers have produced, and will continue to produce, significant benefits for consumers. Most importantly, large, vertically integrated firms have both the incentive and the ability to efficiently finance program production. They are able to assume risks smaller entities cannot take, and they provide a subscriber base of sufficient size to encourage new programming.

The FCC has repeatedly acknowledged that vertical relationships in the cable industry have increased both the quality and quantity of cable programming services.[5] In adopting the vertical ownership provisions of the 1992 Cable Act, Congress also recognized the public interest benefits that derive from vertical integration. For example, it noted that vertical relationships promote program diversity and make the creation of new and innovative programming services

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[5] See, e.g., Competition, Rate Deregulation, and the Commission's Policies Relating to the Provision of Cable Television Service, 5 F.C.C.R. 4962, 5003-11 (1990).

possible.[0] Moreover, Congress understood that vertical relationships are an efficient way of financing new programming services and compensating cable operators for assuming some of the risk associated with the launch of new programming services. In particular, Congress cited C-SPAN, CNN, Black Entertainment Television, Nickelodeon and the Discovery Channel as examples of innovative programming that would not have been feasible without the financial support of cable system operators.[0]

The benefits of vertical ownership are not purely theoretical; rather, they are concrete and widespread. In the 1970's, the program choices available to consumers included three networks, PBS and maybe an independent broadcast signal. Now there are over 160 national satellite program services, including specialty channels devoted entirely to, among other things, children's programming, minority and women's programming, the arts, science, sports, history and government. Many of these services were launched, funded and made successful by significant cable operator investment.

In fact, the cable industry's programming investment has grown dramatically, reaching $6.0 billion in 1997 (see the Chart below). Vertical ownership created the economic underpinnings that allowed companies like TCI and others to take the enormous investment risks associated with the development, launch and distribution of national satellite program services.

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[0] See H.R. Rep. No. 628, 102d Cong., 2d Sess. 41 (1992).

[0] Id. Congress also cited a study by NTIA which concluded that common ownership of cable systems and cable programming services did not appear to affect adversely the supply of cable programming or diversity of viewing choices for cable subscribers. Id. (citing Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Report 88-223, June 1988, p. 102). NTIA found that none of the top five MSOs showed a pattern of favoring basic services with which they were affiliated.

YEAR	EXPENDITURES (IN MILLIONS)	% INCREASE FROM PREVIOUS YEAR	% INCREASE IN CPI-U
1985	$1,859.0	--	
1986	$2,030.0	9.2%	1.2%
1987	$2,289.0	12.8%	4.4%
1988	$2,599.0	13.5%	4.4%
1989	$2,918.0	12.3%	4.6%
1990	$3,195.0	9.5%	6.1%
1991	$3,463.0	8.4%	3.2%
1992	$3,811.8	10.1%	2.9%
1993	$4,000.0	4.9%	2.7%
1994	$4,370.0	9.3%	2.7%
1995	$4,963.0	13.6%	2.5%
1996	$5,656.0	14.0%	3.3%
1997	$5,996.0	6.0%	1.7%
Compound Annual Growth Rate	--	10.3%	3.3%

Source: NCTA estimates based on Kagan Associates numbers and U.S. Copyright Office data.

Program Access.

I am not sure that I understand the controversy about program access. Congress adopted program access to ensure that non-cable distributors have access to satellite cable programming at non-discriminatory rates. It seems clear that this goal has been met.

Non-cable distributors have channel line-ups that look virtually identical to the cable industry's channel line-ups. The program line-ups of each of the DBS operators and various other cable competitors are attached. So far as I can tell, both DirecTV and Ameritech offer all the program services typically offered by TCI, including the major vertically integrated services, such as HBO, CNN, Discovery and Encore. In fact, these non-cable distributors offer much programming that cable cannot offer its customers. For example, DBS offers an NFL football package that cannot be offered by cable because of an exclusivity agreement between DIRECTV and the NFL.

While I am on the subject of exclusivity, I want to tell you about two recent situations in which a non-cable distributor sought to offer services for which TCI had exclusive distribution

rights. The first involved EchoStar's desire to distribute fX. The second involved Ameritech's desire to distribute ChicagoLand, a local service in the Chicago area. In the case of fX, TCI voluntarily waived its right to exclusivity. In the case of ChicagoLand, TCI voluntarily waived its exclusive rights to the Chicago Cubs baseball games carried on the service, which was the matter of particular interest to Ameritech. The letters in which TCI relinquished is exclusive rights to fX and ChicagoLand are attached to this testimony.

To the extent there is a problem with the rate a particular non-cable distributor pays to a vertically integrated programmer, there is no reason to believe that the current rules will not adequately address that problem. In fact, just a few weeks ago, for example, the FCC issued a decision finding that a programmer (CNN) had not fully justified its price to certain C-band operators and ordered the programmer to adjust the price.

Finally, it should be noted that the program access rules have an unfortunate negative impact on the creation of new programming in that they allow non-cable distributors to live off the investment of the cable industry and reduce the incentive for those distributors to create new and diverse programming. And, in fact, none of these non-cable distributors has created any new programming. I have nothing against price competition, but it is not alone sufficient. Our public policy should continue this country's long tradition of encouraging the development of diverse and high-quality programming.

CONCLUSION

In closing, I would like to make a few observations about the status of competition in the telecommunications marketplace today and the role of the government in nurturing and enhancing that competition.

The telecommunications marketplace is extraordinarily complex. It involves not only cable, but broadcasters, satellite companies, the programming community, the telephone and computer industries, equipment manufacturers, equipment retailers and the Internet. These industries are converging in the context of a technological environment that is as dynamic as any this country has ever known.

Some parties have suggested a short-term strategy that would focus solely on the cable industry, isolate a single issue, such as prices, ignore the complicated set of factors that impact prices and adopt regulations that micromanage the pricing and programming decisions of cable operators. We know the results that this approach will produce because we fairly recently went through this process with the 1992 Cable Act, which led to reduced investment in infrastructure and technology, diminished incentives to produce and distribute new programming and an utterly unworkable bureaucratic maze of regulations. In short, this approach has great potential to disrupt the rational transition to the communications system of the 21st Century and very little chance to meaningfully improve consumers' lives.

TCI advocates an alternative approach. We believe Congress should increase the opportunities for all in the marketplace to compete vigorously. If you really want us to invest the enormous amounts of capital required to go head to head with the incumbent local telcos, if you really want

us to deploy high-speed interactive data services that will open countless information and educational opportunities for all Americans, and if you really want us to continue to create highly diverse programming, then the pro-competition policy set out by Congress in the 1996 Act is the right approach. Now, more than ever, we need to promote growth, innovation and risk-taking. That is how we built the cable industry and how our country was forged, and that is how we will build the advanced communications system of the 21st Century.

TCI PER-CHANNEL PRICE ANALYSIS: 1992-1998						
TCI System	**1992 Per-Channel Price**	**1998 Per-Channel Price**	**% Annual Increase/ Decrease in Per-Channel Price**	**1992 Number of Channels in System**	**1998 Number of Channels in System**	**% Annual Increase/Decrease in Number of Channels**
Tucson, AZ	$0.47	$0.52	1.8%	53	55	0.6%
Overland Park, KS	$0.54	$0.49	-1.5%	46	57	4.0%
Battle Creek, MI	$0.72	$0.56	-3.7%	31	50	10.2%
Springfield, MO	$0.57	$0.49	-2.3%	42	54	4.8%
Billings, MT	$0.59	$0.61	.6%	34	52	8.8%
Reno, NV	$0.49	$0.54	1.7%	40	54	5.8%
Salem, OR	$0.68	$0.48	-4.9%	33	59	13%
Corpus Christi, TX	$0.60	$0.54	-1.7%	33	51	9%
Spokane, WA	$0.60	$0.48	-3.3%	34	59	12.3%